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CMP Green Value Score – Overview and Assessment

The [CMP Green Value Score](#) focuses solely on the financially tangible, asset-based attributes that underlie sustainability-related real estate initiatives; more specifically, energy/water efficiency, indoor environmental quality, and location-based attributes that have a direct impact on an asset's net cash flow, liability exposure, and the asset's resultant market value.

The CMP Green Value Score, as defined in the Commercial Green Building Underwriting Standard and the companion Residential Green Building Underwriting Standard ("Standards"), builds upon accepted industry 'green-based' standards – [Energy Star](#), [LEED](#), [Climate Neutral](#) – that are rigorous and third-party verified, two critical components required by the capital markets.

The CMP Green Value Score serves as an enhancement to current underwriting practices. It is a market-based signal indicating an asset with a better financial profile, top-quality operations and management, and reduced risk exposure along numerous fronts.

Specific in purpose and design, the CMP Green Value Score identifies and verifies these 'green' aspects in a way that supports all other underwriting considerations; it is not intended to supplant established industry underwriting processes and guidelines concerning borrower quality, tenant credit, property condition, and other relevant due diligence factors.

As an underwriting enhancement, the CMP Green Value Score is particularly valuable when differentiating assets and/or portfolios with "green" attributes that contain superior financial and risk-reduction characteristics from assets/portfolios that upon first inspection might be deemed a 'market peer'.

By following these Standards, more granular information is obtained leading to superior financial underwriting. As specific example, a Subject asset has a CMP Green Value Score of 68, an Energy Star Score of 72, and a LEED Gold rating having earned five of the 10 energy credits indicating a 25% improvement over a baseline building supported by a rigorous energy model.

The underwriter locates three similar nearby assets (ie 'market comparables') from which to determine the DCF proforma inputs for a valuation analysis using the income approach. These three comparables have Energy Star scores of 46, 52, and 57 and are not LEED certified. Aggregated, these 'comparables' establish the 'market' energy operating expense ("OpEx") line item cost through their weighted average energy consumption at \$3.40/SF/YR.

Given this situation, should the Subject asset be penalized by this underperforming peer group through the application of \$3.40/SF to the energy OpEx line item on the 10-year proforma?

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.....or, given the supporting documentation now at hand should the underwriter apply a 25% factor to the 'market' energy OpEx cost of \$3.40/SF supported by the more granular Energy Star / LEED information obtained through the CMP Green Value Score process?

Four key points:

1. Based on the CMP Green Value Score process and supporting documentation, the Subject asset can essentially support \$2.55/SF on the energy OpEx cost line item within the 10-year DCF proforma when following 'greater of market or actual' conservative underwriting guidelines.
2. Applying a going-forward inflation rate to these energy costs on the 10-year DCF proforma analysis yields a significant difference resulting in a positive impact on the asset's valuation analysis. This \$0.85/SF delta results in a cascading positive effect on key financial ratios including DSCR and LTV which in turn positively impact overall debt proceeds and drives up an equity investor's WACC and ROE disproportionately due to a lower equity outlay coupled with reduced equity risk.
3. The presence or absence of risk-reducing characteristics should impact the 'market' cap rate applied to the Subject asset resulting in either a positive basis point adjustment to the Subject asset's cap rate or a negative basis point adjustment to the 'market' asset's cap rate.
4. The fact that the asset's Energy Star score, LEED rating and resultant CMP Green Value Score were investigated upfront provides greater information to a lender, institutional investor, or secondary market investor as to quality of the underlying collateral and how effectively that collateral is being managed on an asset and/or portfolio basis.

Decision Tool

The CMP Green Value Score is a useful decision tool when determining an asset or portfolio baseline by calling out specific, financially-tangible areas of focus in the analysis, in particular energy and water efficiency, risk-reducing aspects of indoor environmental quality, and positive location attributes.

A high CMP Green Value Score serves as an indicator of reduced exposure to financial operating risk, reduced exposure to energy/water price volatility and price pressures from increased scarcity, reduced litigation liability exposure, and reduced obsolescence risk exposure among others.

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A low CMP Green Value Score serves as an important asset and/or portfolio management tool by indicating:

1. Forward-looking 1-3 year capital budgeting needs
2. Specific areas of impact to focus on with these capital improvements
3. Advance knowledge of the looming re-pricing / re-trade discussion at time of disposition or refinance due to the asset's lack of 'green' characteristics

Relevant Macro Issues

The [Capital Markets Partnership](#) has over 70 member institutions that actively supported the development of these Standards. The Standards were approved as consensus industry standards having gone through a rigorous ANSI-approved public comment and voting process. Significant comments were put forward by representatives from Bank of America, EPA, Jones Lang LaSalle, Marx Okubo, Environmental Bankers Association, publically traded REITs, institutional investment advisors, and other private market actors among numerous others. This input and overall process led to structural improvements in the Standards and clarifications on intent / implementation.

During the Standard's development process, the US Conference of Mayors codified their strong support for this initiative through a [resolution passed at the 2008 annual conference](#). Federal officials in both the Bush Administration and Obama Administration lent their support to this industry effort given the Standard's broad, far-reaching impacts on numerous public policy fronts.

Given the parameters of the [American Recovery and Investment Act of 2009](#) and its specific focus on building efficiency and renewable energy, real estate lenders and investors know that efficiency metrics will be a critical component when articulating asset value over the term of their investment horizon. Additionally, with the passage of [California AB 1103](#) all buildings in the State of California must report their Energy Star score starting on January 1, 2010 for any lease transaction or change of ownership which will likely result in a national ripple-effect to engage in the same reporting over time.

Each of these are clear market indicators for the data points identified in the Green Building Underwriting Standards to be both included in financial underwriting and then reported to primary and secondary market investors.

Once the CMP Green Value Score and the underlying Energy Star, LEED and Climate Neutral standards are implemented by the real estate industry and applied across numerous real estate assets/portfolios, more extensive national statistical data will be obtained by the investment banks, rating agencies, lenders and private market investors. This is similar to the trajectory of the implementation and risk analysis process for the Phase 1 Environmental Site

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Assessment report and the Property Condition Assessment Report, two industry standards that have become embedded in the real estate capital market underwriting process due to their risk reduction characteristics.

In the current environment, the investment market is not waiting 5-7 years for 'perfect' data to somehow emerge and instead has embraced the added value characteristics inherent to green buildings based on these common sense metrics. Capital Markets Partnership member financial institutions have invested over \$30 Billion in green buildings and continue to actively pursue these assets. Thus, a measurement tool that clearly identifies areas of increased cash flow and reduced expenses was created to identify and differentiate these assets and areas of financial impact.

As Jones Lang LaSalle's March 2008 report titled ["The Role of Finance in Environmental Sustainability Efforts"](#) clearly concluded, finance professionals seek tools to apply when incorporating sustainability-related metrics into their processes; the CMP Green Value Score fills this real estate industry need.

Application – CMP Green Value Score

Take the case of two 200,000 SF office assets that are located in the same suburban submarket and were delivered in 2007 with similar floor plates, build-out quality, and amenities. The two assets are judged by knowledgeable professionals as 'market peers'.

Asset A scores an 82.5 CMP Green Value Score due to a top-quartile Energy Star score of 87; an onsite shuttle bus to mass transit; investment in energy and water efficient features including dual high-efficient chillers with VAV boxes, motion/daylight sensors in tenant and common spaces, T-5 lighting throughout, and low-flow fixtures / drip irrigation that cut water use nearly in half; 100% fresh air exchanges every hour; an overall LEED Platinum rating; and a long-term energy contract to purchase wind energy at a fixed price with the resulting environmental benefit of being climate neutral.

Asset B scores a 28.2 CMP Green Value Score. It was built to municipal code standards, has a median Energy Star score of 49, implemented few energy/water efficiency features during construction and TI build-out, did not pursue a LEED rating, and is exposed to higher peak rate energy pricing and ongoing energy price volatility for grid-based energy due to inefficient onsite energy management and lack of energy efficient features. The façade, lobby, elevators, common spaces, and onsite amenities are of similar aesthetic quality as Asset A giving the impression of 'peer equality'.

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Which asset would you expect to have:

- Greater financial operational risk
- Greater financial obsolescence, re-pricing / re-trade, or capital investment risk at time of loan maturity or asset sale
- Greater cash flow stability – both in ongoing asset operations as well as in the re-leasing absorption / TI scenario as tenant leases turn over
- Better overall market positioning upon a refinancing and/or asset disposition event

The answers become apparent only after a detailed analysis and scoring using the CMP Green Value Score.

These same four questions can be applied to a \$XX Billion portfolio of assets where Portfolio A has a weighted CMP Green Value Score of 71 and Portfolio B has a weighted CMP Green Value Score of 29. Which portfolio indicators point to less inherent risk? Which portfolio would you prefer to hold?

And what do these answers mean collectively when predicting future rational investor behavior over the next real estate cycle and beyond?

It bears emphasizing that lenders and equity investors that acquire key information during due diligence underwriting including an asset's Energy Star score and LEED rating must delve deeper into understanding exactly which LEED points are included in the LEED rating. Not all LEED points are created equal. LEED points that reduce the overall financial risk exposure and/or the severity of that exposure at the asset and portfolio levels are significantly more valuable. Providing market guidance on these financially-tangible, risk-reducing attributes in a standardized fashion is the essence of the CMP Green Value Score scoring and reporting process.

The CMP Green Value Score underwriting overlay tool is a standardized and disciplined process that is simple to implement. It serves as an additional indicator of value when coupled with traditional underwriting methods. Utilizing the Standard's process, value indicators, and resultant Green Value Score is an important component to fulfilling an [investor's and lender's fiduciary duty](#) when seeking relevant, financially tangible criteria from which to base their investment decisions.

It should be noted that Asset A in the example above is the [Tower Oaks office building](#) in the Washington, DC suburb of North Bethesda, MD.

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Meaning of the CMP Green Value Score

The real estate industry finds itself at an important crossroads concerning asset underwriting. Improved underwriting practices, increased transparency, and third-party verification will go a long way to raising investor confidence.

Underwriting improvements tend to be evolutionary, not revolutionary, as new best practices are introduced incrementally over time. Of note, the roots of the current Phase I ESA process only date back to 1988; it was developed into an industry standard and introduced into the market in 1993. The Property Condition Assessment Report was developed in 2001 and codified in ASTM in 2002.

Incremental improvement is typically a function of raised issue awareness, increased information availability, introduction of technological tools, and risk-based market drivers. The CMP Green Value Score is the product of all four of these influences.

Industry adoption of the CMP Green Value Score benefits developers and equity investors who embrace 'green' risk-reduction strategies, brokers who represent these projects, lenders who provide debt financing, and portfolio investors / secondary market participants charged with making buy/hold/sell decisions. Larger far-reaching benefits accrue as private market actions reinforce public policy goals.

It is important to realize that for every asset that scores high on the CMP Green Value Score, there are 10+ assets that score low, in part due to the lack of attention the real estate community has placed on sustainability to this point in our economic history. The median CMP Green Value Score falls in the 23-27 range with a tight bell curve ranging from 18 to 30. Assets scoring 50 or higher on the CMP Standard demonstrate clear separation from a 'market' peer group and should merit 'top-of-stack' consideration in any debt/equity financial transaction.

The Standard is purposefully crafted to provide significant room for improvement on an initial asset or portfolio benchmark. A median score of 25 can be both discouraging and filled with opportunity depending on one's perspective. As the real estate industry continues moving forward on sustainability initiatives, the median CMP Green Value Score will increase over time marking the industry's progress toward greater financial risk reduction and its environmental stewardship concerning our shared societal resources.

The Capital Markets Partnership looks forward to broad real estate industry involvement in adopting and implementing these Standards and the positive impacts they bring to increasing underwriting quality, investment discipline, information transparency, and investor confidence.